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VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte*, WC Docket No. 03-228, Section 272(b)(1)'s Operate
Independently Requirement for Section 272 Affiliates

Dear Ms. Dortch:

On Monday, January 12, 2004, Aryeh Friedman and the undersigned, representing AT&T, met with Scott Bergmann, Pamela Megna and Christi Shewman of the Wireline Competition Bureau's Competition Policy Division. The purpose of the meeting was to review AT&T's filed comments in the above-captioned proceeding. The attached outline reviews the topics covered and the positions taken by AT&T in this proceeding and covered at our meeting today. In addition, the outline, when discussing the efficiency of a price cap regime, references legislation recently passed in the state of Florida. At the FCC staff's request I have attached a copy of the Florida statute to this Notice.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

ATTACHMENTS

cc: S. Bergmann
P. Megna
C. Shewman

Section 272(b)(1)'s Operate Independently Requirement for Section 272 Affiliates

I. *The Commission May Not, As A Matter of Law, Modify Or Eliminate Its Joint Ownership or OI&M Safeguards*

1. Section 272(b)(1): The "operate independently" expressly precludes integration of the BOC's local network facilities with the long distance facilities of the § 272 affiliate. Elimination of the joint ownership and OI&M safeguards would result in *dependent*, not independent, operation.

2. Section 272(a): *Congress's* separate affiliate requirement is a complete bar to the integration of the BOC's local and long distance facilities. Elimination of the joint ownership and OI&M safeguards would make the BOCs' § 272 separate affiliates into mere shell corporations.

3. The Act's non-discrimination provisions, *see* §§ 272(c)(1); 272(e)(4): Common ownership will necessarily preclude non-affiliated competitors of the RBOCs from negotiating and acquiring comparable interests in the RBOC switches and transmission facilities. Because § 272(e)(4) also underpins these requirements, the structural separation measures at issue may not be limited in duration.

4. Prior Commission determinations and policies: The Commission's decision rested directly on the *Computer II*, *BOC Separations Order*, and *Competitive Carrier Orders* and elimination of the joint ownership and OI&M safeguards would be a repudiation of those Orders as well.

5. The Relevance of the Prior Forbearance Proceedings:

(a) The BOCs never sought forbearance from the joint ownership requirement presumably because they too understood that this was a minimum requirement of the statute. They barely address the issue even in this proceeding.

(b) *ASCENT v. FCC*: The Commission cannot achieve by rulemaking that which it is not allowed achieving by forbearance. Congress clearly intended that the joint ownership and OI&M safeguards be in place for the initial three years, and in obtaining Section 271 approval the BOCs expressly committed to comply with those safeguards for a minimum of three years.

6. SBC's request for a "waiver" of the SBC/Ameritech merger conditions that regulate OI&M services between SBC's incumbent LEC subsidiaries and SBC's "separate" advanced services affiliate (SBC Reply Comments at 3, n.6) is beyond the scope of the Public Notice and is, in any event without merit as explained in AT&T's Opposition to SBC's prior request in the context of forbearance.¹

¹ For the reasons set forth in AT&T's Reply Comments there is no basis for the Commission to preempt the states from prohibiting joint OI&M, nor can the Commission

II. *The Joint Ownership or OI&M Safeguards Are Essential to Deter and Detect Cost Misallocation and Discrimination, and to Create a Level Playing Field in the Long Distance Market*

1. *These Safeguards Apply to Core Network Facilities:* Competitive carriers remain highly dependent upon the facilities that will now be jointly owned by the BOCs and the Section 272 affiliate. These facilities remain essential for competitors to provide local telephone services as well as to originate and terminate long distance and broadband services. The Commission found in the Triennial Review Proceeding that self-deployment of competing facilities would be uneconomic because of enormous entry barriers.

2. BOC claims of intermodal competition from wireless and Voice over IP are highly overstated, as demonstrated by AT&T in the Non-Dominance FNPRM. For example, the BOCs' claims as to wireless fail to recognize that wireless service providers are highly dependent on ILEC special access facilities² and materially overstate the extent of wireless substitution. *See e.g.*, 12/10/2003, Chicago Tribune, Demand lacking for home-to-cell phone number moves, by Jon Van ("Local phone companies had predicted that hundreds of thousands--possibly even millions--of customers would abandon wired phone service when new federal rules allowing such a switch took effect two weeks ago. But the number who actually have taken the plunge is very small, numbering in the hundreds, SBC Communications Inc. reported Tuesday.")³

A. *Cost Misallocation:*

1. *Joint Ownership:* The costs of telephony networks are largely fixed and largely shared among local, access, and other services. Joint ownership would dramatically increase the magnitude of joint and common costs and increase the likelihood of improper cost allocation. Applying cost allocation rules to jointly owned, vertically integrated core network facilities will require new and difficult judgments of inherently arbitrary allocations and detailed oversight of the BOCs' costs.

2. *OI&M:* It was very clear from Verizon's submissions that it intended to use an artificially low "incremental fully distributed cost" methodology to charge its long

lawfully grant SBC's alternative request to "clarify" that the Act and OI&M rules do not prohibit other BOC affiliates from performing OI&M services.

² See the AT&T Wireless Non-Dominance FNPRM Comments, WC Docket No. 02-112 and CC Docket No. 00-175 (filed June 30, 2003).

³ For the reasons set forth in AT&T's Reply Comments, CLECs and other carriers often do not provide alternative services at all, and where they do, they are extremely limited in scope.

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distance affiliate for maintenance and repair services⁴ that even BellSouth admits is improper. BellSouth's Reply Comments herein at 13 and note 27 (admitting that Section 272 affiliate transactions are supposed to be based upon "arm's length" market price principles requiring that the BOC ILEC realize the full market value of the service provided, not merely that it be reimbursed for its costs). Verizon's methodology would improperly shift the costs of the OI&M service from the long distance affiliate to the BOC ILEC and its ratepayers. It is this cost shifting that can facilitate a price squeeze strategy.⁵

3. *Elimination of these Safeguards would Require Substantial Structural Modification of the Cost Allocation Rules and Extensive Auditing:* Elimination of these safeguards would require substantial modification of the cost allocation rules (and even then, it is far from clear that the cost allocation rules, as modified, would be sufficient). It would also involve extensive auditing and monitoring of the BOC's day-to-day activities in order to ensure that the BOCs will not use joint ownership or OI&M as a tool for anticompetitive practices. Moreover, after the fact audits, such as the Section 272 audit, have been relatively ineffective in detecting or deterring BOC misconduct. See the recent *Verizon NAL*.⁶

4. *Price Caps Do Not Eliminate the Incentive or Ability to Misallocate Costs:* The "index" used to adjust rates is always subject to change by the regulator, and the typical basis for altering the index is that a company's costs have increased at a greater rate than the index. *The BOCs have enormous flexibility under price cap regulation to raise prices.* For example, the Florida legislature recently allowed BellSouth (after reducing access charges) to annually raise prices on basic services by up to 20% in exchanges where a CLEC is providing service. At the end of December, the Florida PSC approved the BellSouth (and Verizon and Sprint) proposals for a revenue neutral reduction in access charges

⁴ Verizon Reply Comments in this proceeding at 20 and note 40, and its August 11, 2003 *ex parte* in the Verizon OI&M Forbearance *Proceeding*, CC Docket No. 96-149, at 3; Howard Supplemental Declaration ¶ 5.

⁵ Thus, BellSouth's reliance on Dr. Tardiff's Declaration about the pricing of access costs (BellSouth Reply Comments at 8-9) is misplaced. AT&T's claim is that a misallocation of OI&M costs, not *access costs*, will facilitate a BOCs price squeeze strategy.

⁶ *In the Matter of Verizon Telephone Companies, Inc. Apparent Liability for Forfeiture*, File No. EB-03-IH-0245 (rel. Sept. 8, 2003), where, *e.g.*, all the Commission could do for one set of violations was "admonish the company" "because we are barred by the one year statute of limitations," *id.*, ¶ 13, and where Verizon substituted its own performance measurements for those mandated by the Audit requirements, effectively masking other potential violations. *Id.*, ¶ 16, n.18.

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B. Discrimination:

1. *Joint Ownership:* Joint Ownership would result in arrangements that inherently discriminate against rivals to the BOC's § 272 affiliates. The affiliate would not have to contract with the BOC to obtain jointly owned facilities, thereby precluding a comparison of the terms of transactions between a BOC and a section 272 affiliate with the terms of transactions between a BOC and a competitor of the section 272 affiliate. The "consideration" for such ownership interests would simply flow from one RBOC account to another, ensuring that no bona fide arm's length arrangements exist, much less that such arrangements would be offered to competitors on like terms. SBC's assertion in its Comments that joint ownership of the network provides a "measure of control over how it is configured and used" concedes the inherent risk that it will be configured and controlled in ways that advantage the BOC affiliate and discriminate against unaffiliated providers.

2. *OI&M:* Verizon, in the OI&M Forbearance proceedings stated that if the OI&M forbearance petition is granted, Verizon would use "the local exchange carrier's OSSs to provide OI&M services to the section 272 affiliate" with *all* upgrades paid for by the BOC ILEC.⁷ As AT&T demonstrated in that proceeding, this would *necessarily* afford the 272 affiliate superior access to the BOC's OSS systems. Dr. Selwyn further demonstrated that the BOC could treat both the upgrade and subsequent ongoing maintenance expenses as a "common cost," and "*any non-zero allocation of these incremental system development and maintenance costs to POTS would have the effect of shifting costs away from the competitive long distance company and onto regulated monopoly local exchange service*" (emphasis in the original).⁸

3. *Difficulty of Detecting Discrimination:* Contrary to the assertions of SBC (Reply Comments at 5) elimination of the joint ownership safeguard materially complicates the detection of discriminatory conduct, by masking the source of the discrimination. The ability of BOCs to manipulate the mode of interconnection by unaffiliated as compared to affiliated carriers would be increased.

4. *BOC Contracts with 272 Affiliates Are Not Practically Available to Unaffiliated IXCs:* As AT&T has demonstrated in the Forbearance proceedings, the BOCs have crafted contracts that limit the ability of competitors to qualify for the service

⁷ Verizon's October 27, 2003 *ex parte* in the *Verizon OI&M Forbearance Proceeding*, CC Docket No. 96-149 at 4.

⁸ See *Ex parte Declaration of Dr. Lee L. Selwyn* filed on behalf of AT&T, July 9, 2003, in the *Verizon OI&M Forbearance Proceeding*, CC Docket No. 96-149, at para. 18.

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in question. *E.g.*, Verizon's and SBC's billing and collection services and BellSouth's growth tariff (the last recently withdrawn).⁹

5. *Virtual Collocation is Not Comparable*: The fact that the BOCs, in the context of providing virtual collocation also provides related OI&M services to their affiliates (BellSouth Reply Comments at 15), demonstrates both the extensive regulatory oversight needed to ensure non-discrimination – virtual collocation is typically subject to extensive performance metrics – and the inadequacy of the BOCs request here that the Commission simply abandon its OI&M safeguard without imposing any similar performance metrics on newly permitted OI&M services.

III. The BOCs Success In the Long Distance Market Belie their Claim That the Joint Ownership or OI&M Safeguards Have Imposed Any Burden At All.

1. The BOCs cost data is unsubstantiated, and the Verizon and SBC claims that they incur hundreds of millions of dollars in costs grossly exaggerated. The BOCs never address BellSouth's evidence showing that the absolute cost of OI&M services for its long distance operations, which provide services to about 3 million subscribers, is \$3.3 million a year – or about 9 cents per month for each of BellSouth's customers.

2. The BOC's disparate cost claims:

BOC	Publicly Disclosed Claimed Cost of Structural Safeguards
Verizon	\$300 million from 2002 to 2006 on top of additional costs prior to 2002. Verizon Comments at 15
SBC	\$77.8 M/year (or \$233.4 over 3 years), OI&M Forbearance Petition at 20.
Qwest	"Qwest incurs very few OI&M costs," OI&M Forbearance Petition at 7.
BellSouth	\$3.3M a year, 9/15/03 OI&M Forbearance <i>ex parte</i> at 3.

BSLD "has outsourced most OI&M function." 9/15/03 *Ex Parte* at 3. Perhaps Verizon and SBC should outsource to the same vendor.

3. BOC claims to the Commission that these safeguards have affected broadband deployment and enterprise business services are contradicted by what the market and SBC are reporting. BellSouth can now reach 85% of its customers at 3 Mbps and 50% at 5 Mbps, more than enough for its current needs.

http://dslprime.com/News_Articles/news_articles.htm. The same is true for SBC – its "Broadband footprint to reach nearly 80% of total customer locations" and nearly half of DSL capable locations are able to achieve speeds of 4 to 6 Mbps. http://www.sbc.com/Common/files/pdf/SBC_Lehman.pdf, slides 10 and 19.

⁹ See AT&T's October 1, 2003 *ex parte* in the *Verizon OI&M Forbearance Proceeding*, CC Docket No. 96-149 and AT&T's October 27, 2003 *ex parte* in the *SBC OI&M Forbearance Proceeding*, CC Docket No. 96-149, 98-141.

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4. SBC recently told Wall Street analysts and investors that:

(a) It's long distance share is growing at unprecedented rates: "As you look at our penetration rates, we've achieved 32% in the consumer market in California in just nine months and 54% in Southwest in just over three years."

(b) The enterprise business segment was "really a sweet spot for SBC and reflects our capabilities and infrastructure today" and that it has been very successful in this segment, especially in Frame and ATM, giving the following examples: "we recently closed a \$350 million, 5 year contract for a nationwide frame-relay network ... [a]nother example: a \$9 million, 3 year contract ... [that] requires a 580 site frame relay network. Two more: a \$10 million, 3 year contract ... includes a 221 site frame relay network ... [a]nd finally, we closed a \$10 million contract which includes a 104 site frame relay network."

(c) Its broadband deployment is more than sufficient for existing and future needs: "While we are clearly the largest DSL provider, we believe that within our footprint, we are at parity with cable modem ... Today our users typically get download speeds of about 1.5 megabits per second, which accommodates almost all of the download speeds of current applications and servers. But we also have the ability to offer four to six megabits to about 50% of the locations passed (ph) today. The bottom line is that we have the ability to meet future requirements for applications at increased speed when the need arises."

CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, (submitted with AT&T's Extension Of Section 272 Obligations in Kansas and Oklahoma Reply Comments, WC Docket No. 02-112, filed December 29, 2003, Attachment 7).